

STATE OF ARIZONA

Janet Napolitano, Governor

**Budget Briefing Materials
Fiscal Year 2008**

January 12, 2007

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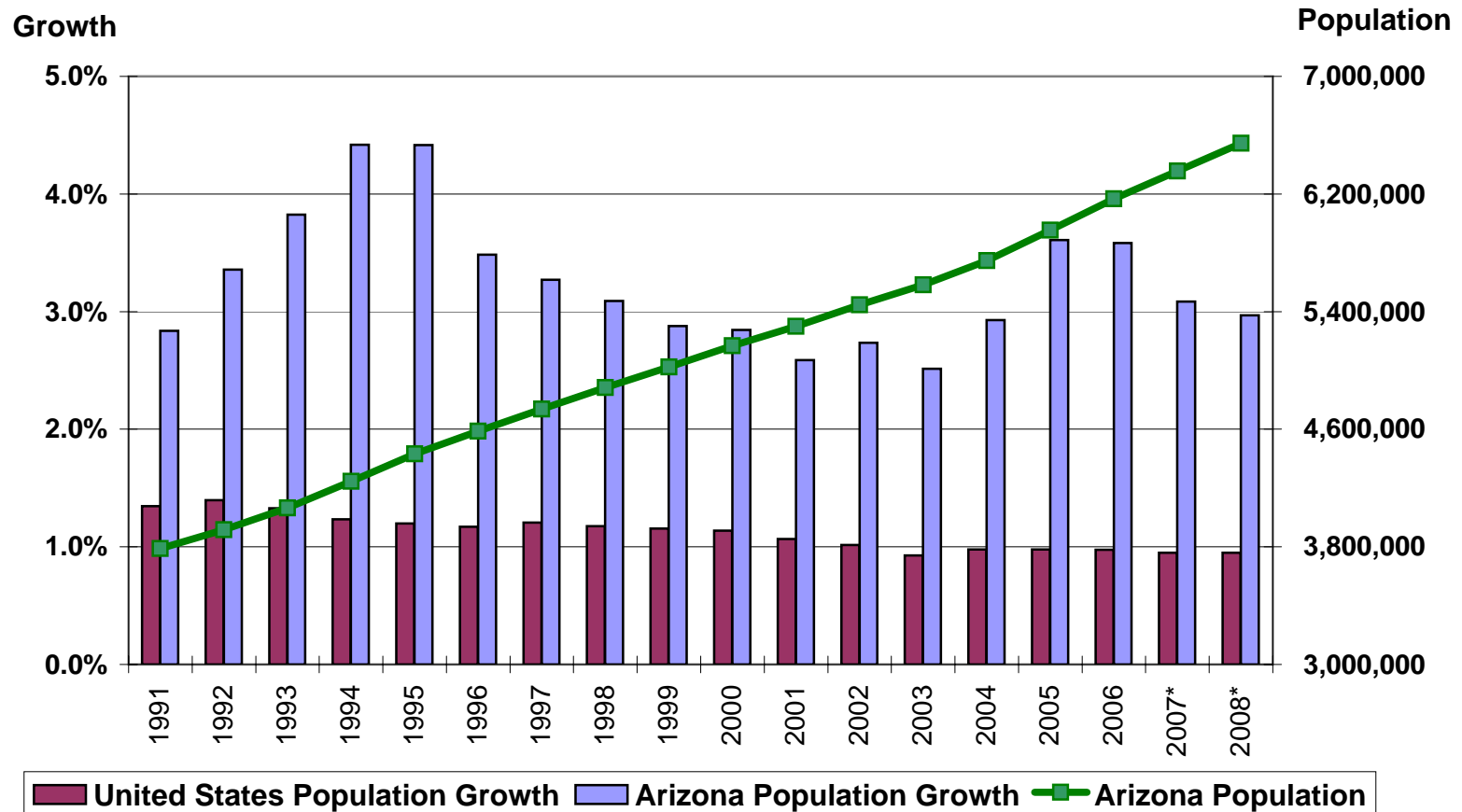
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Section 1

**Backdrop and Perspective for Building the
FY 2008 Budget**

Arizona's Explosive Growth: Population

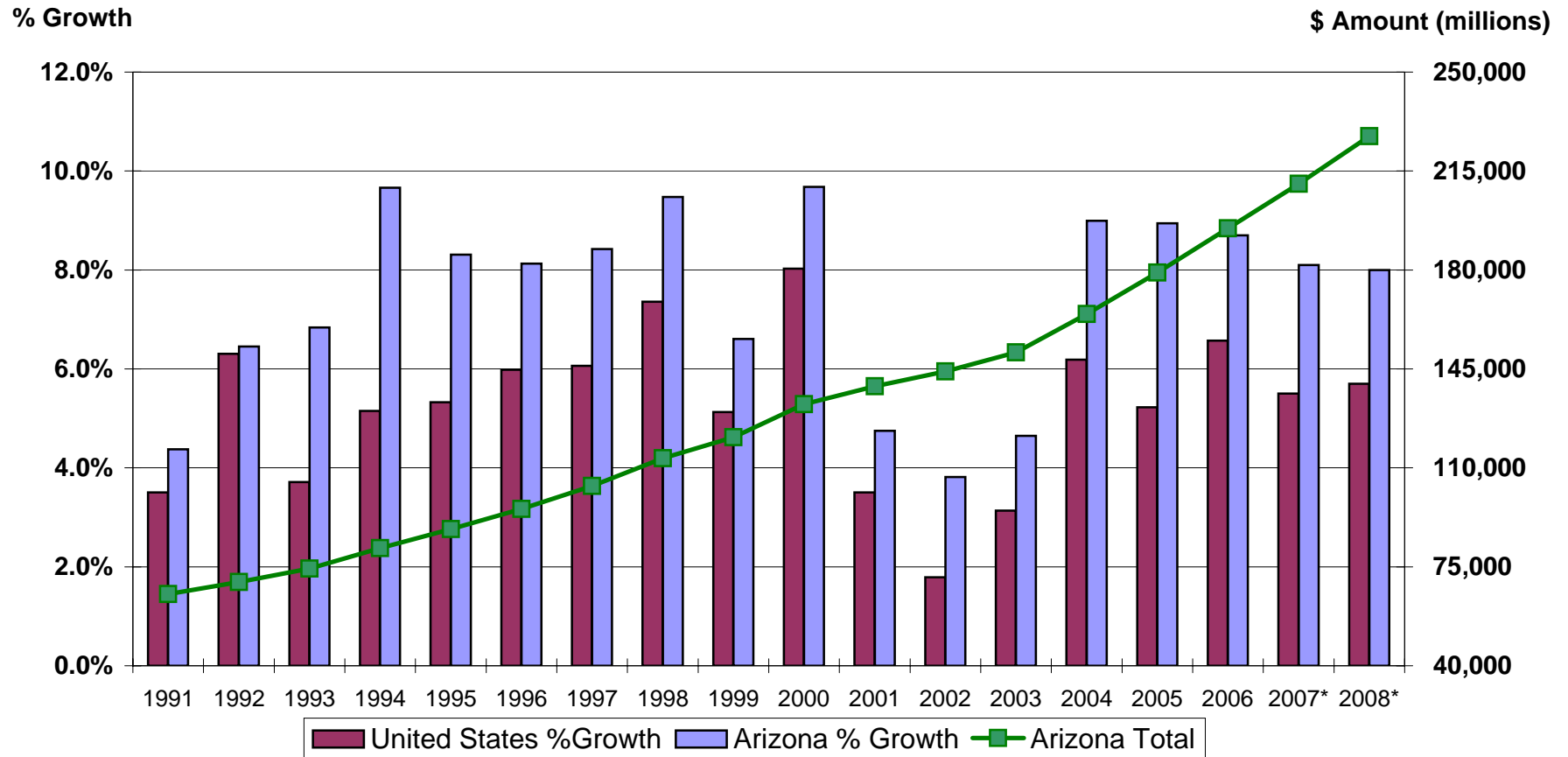


Source: US Census Bureau

*2007 and 2008 are projections from US Census Bureau and Arizona Department of Economic Security

In CY (Calendar Year) 2006, Arizona ranked as the nation's fastest growing state in population, with 3.6% annual growth. Arizona added 213,311 people in '06 - this is equivalent to adding a city the size of Scottsdale, making AZ one of the nation's top 5 numeric gainers. With total population of 6.2 million, Arizona is now the 16th largest state in the US.

Arizona's Explosive Growth: Personal Income

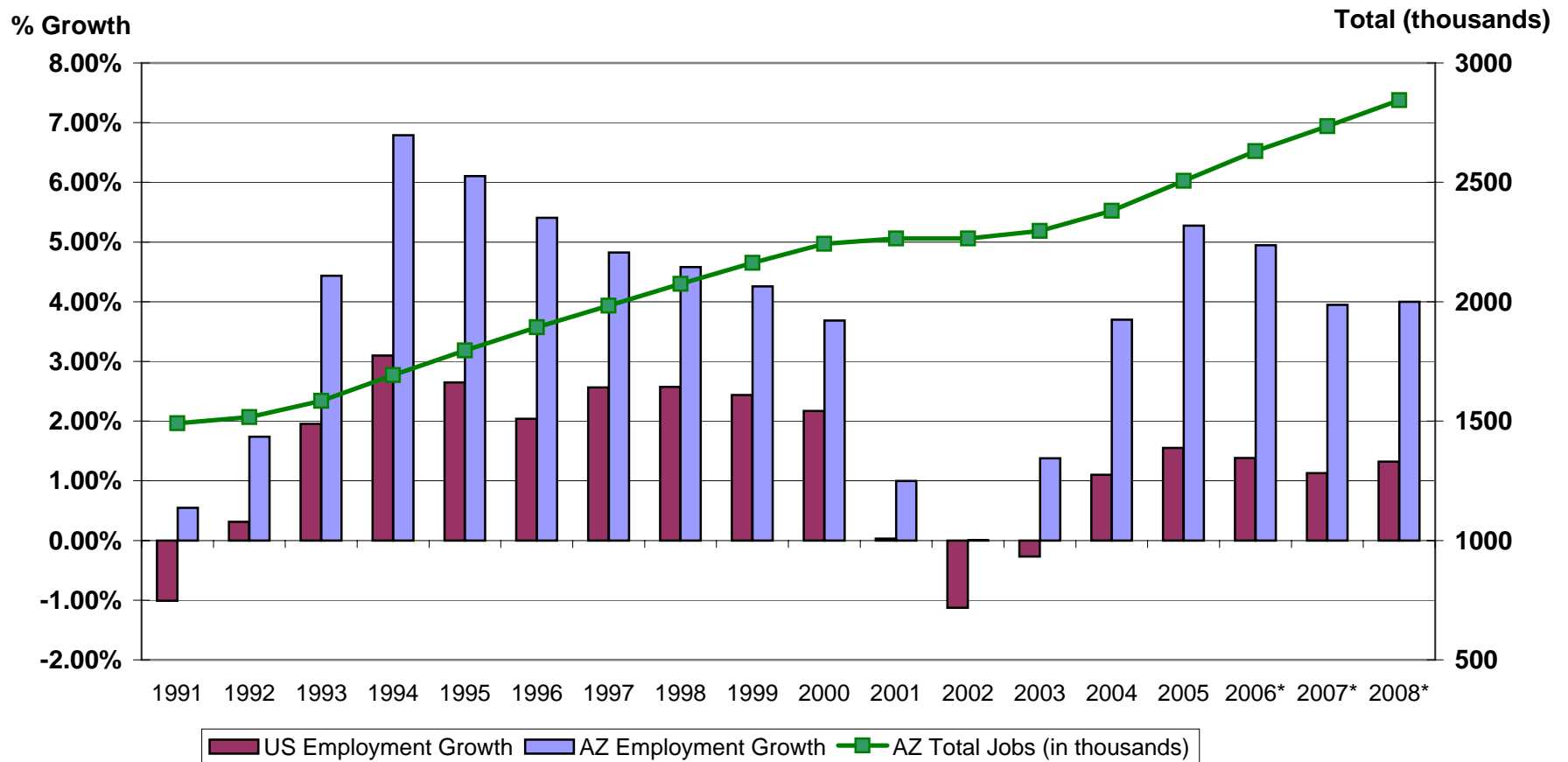


Source: Bureau of Economic Analysis

* Projections: US projection from Global Insight, Arizona projection from ASU

Arizona is the nation's fastest personal income (PI) growth state, with annual PI growth of 8.9% in CY 2005. Personal income growth in CY 2006 continues to be robust at 8.7% average for the first 3 quarters.

Arizona 's Explosive Growth: Employment

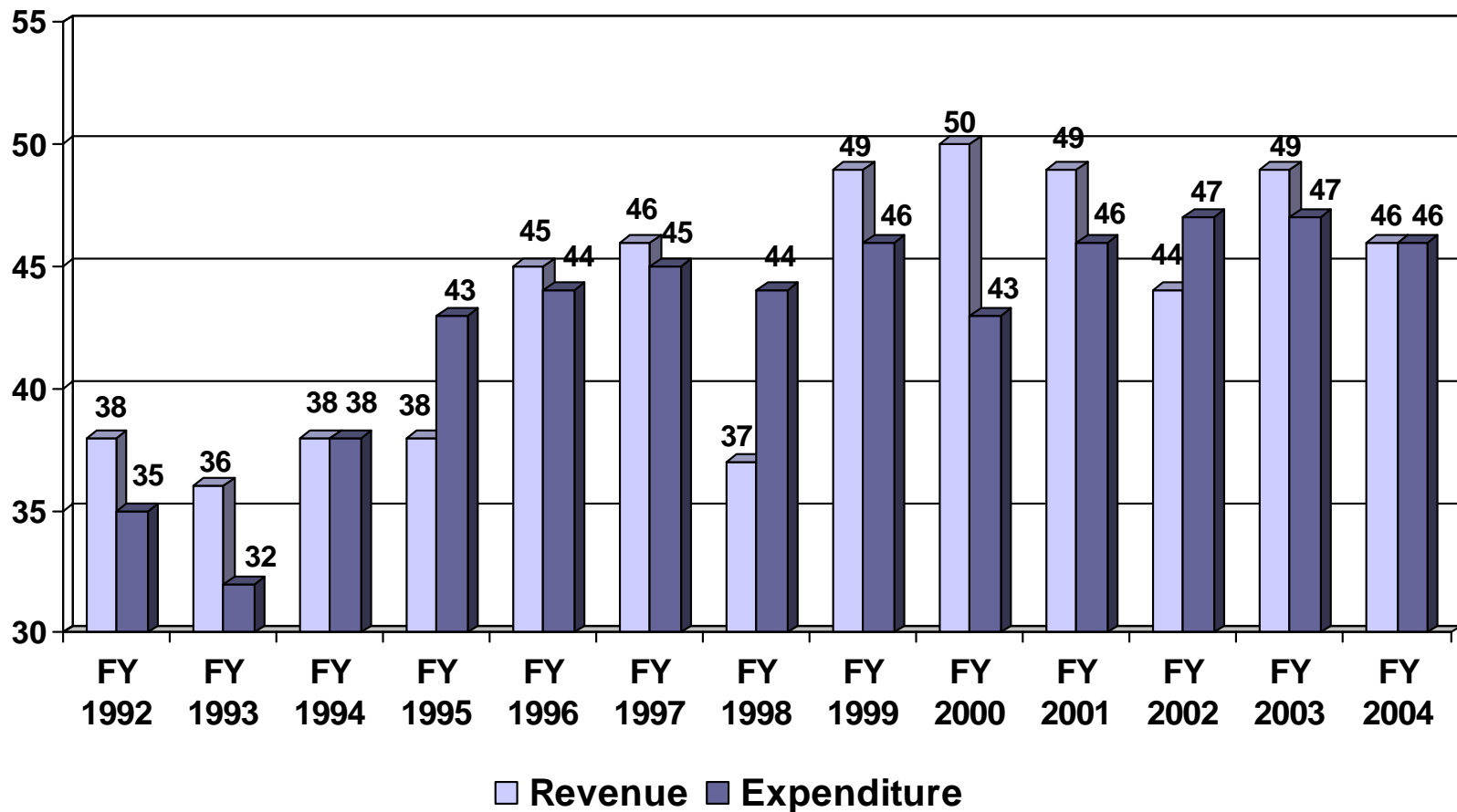


Source: Department of Economic Security

* Projection for 2006 and 2007 based on DES forecast, for 2008 from ASU

Arizona is one of the nation's fastest job growth states. In November 2006, Arizona ranked 3rd in the nation in job growth over the previous year. Arizona is estimated to add 124,000 jobs in CY 2006, for a total of 365,700 new jobs since 2003.

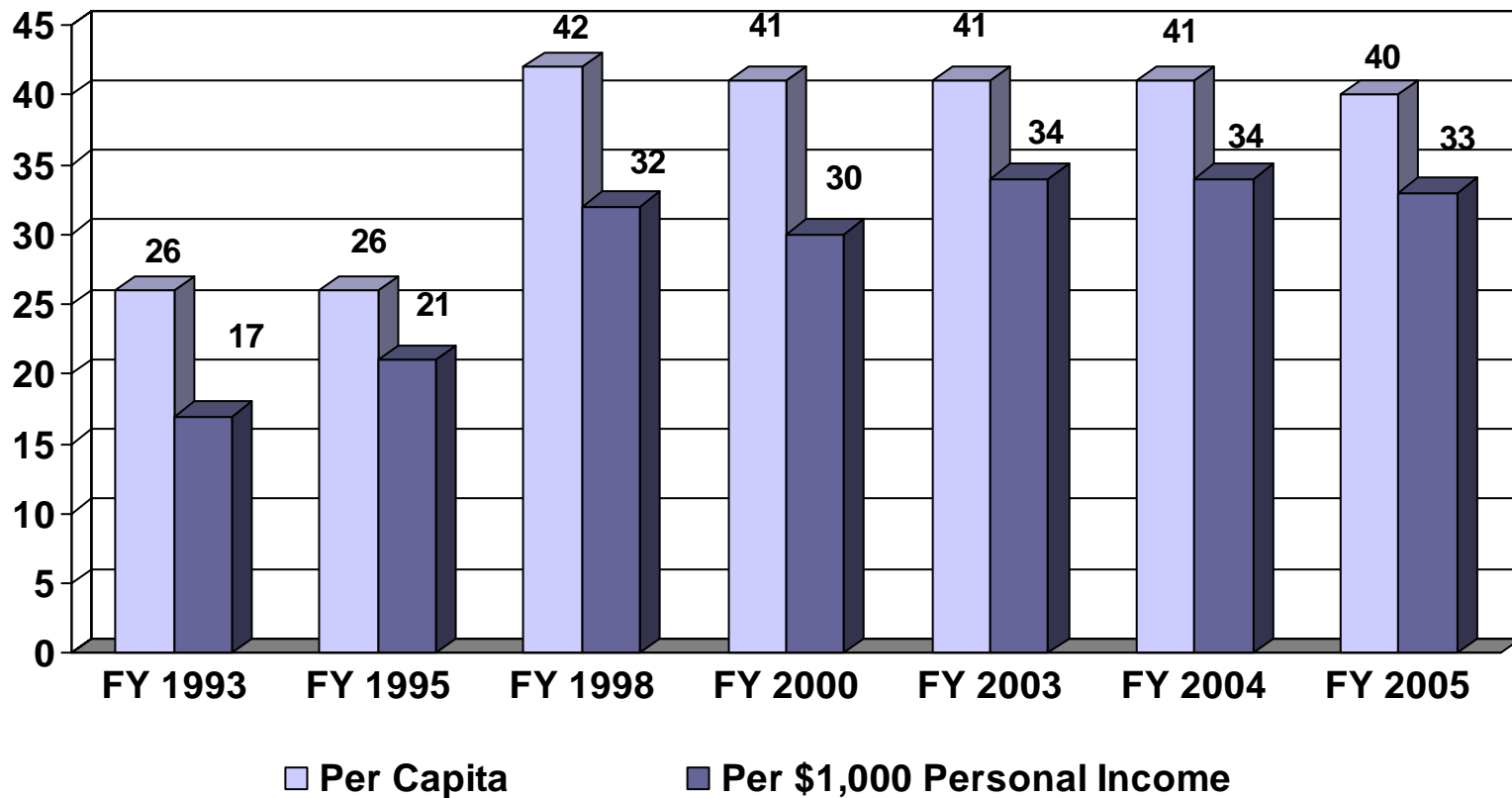
Historical Review of Arizona Per Capita State Revenues and Expenditures Rankings* Compared to Other States



Source: US Census Bureau, excludes DC. The most current data available is 2004 as of 1/2/07. The data include revenues from all sources, including General Fund, Federal funds, and fee collections.

* The higher the rank number, the smaller the revenue or expenditure. For example, Arizona ranked 46th of 50 states in term of per capita revenues and per capita expenditures in FY 2004.

State Tax Collections Rankings Per Capita and Per \$1,000 of Personal Income*



Source: U.S. Census Bureau. The most current data is 2005 as of 1/2/07

*The higher the ranking, the comparatively lesser the state tax burden. For example, Arizona ranked 40th of 50 states in per capita tax collections, and 33rd of 50 states in tax collections per \$1,000 of personal income in FY 2005.

Section 2

Economic Assumptions

Economic Indicators – Calendar Years 2005 Through 2007

I. National – Positive

- Growth in real Gross Domestic Product (GDP) during 2006 was solid, at over 3.0%; 2007 GDP growth is expected to slow and is projected at 2.5%.
- Employment growth of 1.4% in 2006 was moderate.
- Consumer spending has sustained growth despite deceleration in housing activity. Expect cutbacks in consumer spending in 2007, especially for durable goods.
- The Fed fund rate, currently at 5.25%, will likely ease in 2007.
- Business spending increased in 2006 and is expected to support growth in 2007, but will not fully offset consumer and housing slowdowns.
- The dollar strengthened considerably in early 2005 but declined in 2006; further decline is anticipated in 2007, but not at precipitous levels. The decline of the dollar makes US exports cheaper, therefore promoting greater US exports.
- Trade deficit peaked at more than \$900 billion in the 3rd quarter 2006; the deficit expected to ease to just above \$800 billion in 2007.

II. National – Risks

- Softening in the housing market could lead to a bumpier-than-expected landing for the sector. The effect of housing market downturn could be deeper if regions heavily dependent upon the real estate expansion lose economic momentum.
- Possible spillovers from the hardship of the Midwest's structural manufacturing slump could cause further erosion in the economy.
- Energy prices: If prices for natural gas and oil increase and remain at high levels, the inflation rate could rise and lead to further increases in interest rates. The combination of high inflation and interest rates, coupled with a deeper housing decline could push the US into a recession.

III. Arizona – Positive

- Population growth in 2006 was 3.6% annually, ranked 1st in the nation; in-migration/in-flows remain strong.
- Employment growth will continue to accelerate; Arizona does well in comparison to rest of nation:
 - In Nov 2006, Arizona ranked 3rd in the nation in over-the-year job growth. Arizona is estimated to add 124,000 jobs in 2006, for a total of 365,700 new jobs since 2003.
 - Increased business spending at national level – significant benefit to Arizona manufacturing hi-tech companies
 - Big corporations such as Google and Intel are expanding in Arizona, creating new high-wage jobs.
 - Tourism in Arizona is also tied to increased business spending.
- Personal income (PI) growth for 2005 ranked 1st in the nation, estimated at 8.9%; 2006 PI growth continued to be robust at 8.7% for the first 3 quarters.
- Consumers continue to spend; retail sales up 8.1% from last year, could possibly slow with 6.6% growth in 2007.

IV. Arizona - Risks

- Any prolonged national downturn will adversely affect the state as it has in the past. Arizona's export, construction and hospitality industries would suffer.
- Arizona is more exposed than most states to the real estate cycle. The state enjoyed considerable growth and prosperity in the up trend of the cycle and in 2007 will experience a drag due to the slowing of real estate activity.

Principal Economic Assumptions underlying the Revenue Forecast for the FY 2008 Executive Budget

National:

- **US Real Gross Domestic Product (GDP)** is forecast to grow at a moderate rate of 2.0% in FY 2007, and improve in FY 2008 at a solid rate of 2.9%.
- **US GDP Deflator** is expected to stay approximately at 1.9% in both FY 2007 and 2008.
- **S&P 500 Index** is assumed to grow at the average rate of 8.1% in FY 2007, and 8.0% in FY 2008.
- **Real Estate Activities** dramatically decline from the FY 2006 level, and is forecast to decrease 21.8% in FY 2007, but will gradually recover in FY 2008 and beyond, growing at 1.3% in FY 2008.

Arizona:

- **Arizona Population Growth** is robust, and is forecast to grow at 3.2% in FY 2007, and at 3.0% in FY 2008.
- **Arizona Personal Income Growth** will remain very strong in FY 2007 at the rate of 8.4%, and is expected to be solid in FY 2008 as well at a slightly lower rate of 8.2%.
- **Arizona Employment** is forecast to grow at a solid rate of 4.4% in FY 2007, and at a somewhat lower but healthy level of 4.0% in FY 2008.

Source: Arizona State University and Global Insight

FY2007 and FY 2008 Revenue Forecasts
General Fund
(Dollars in Millions)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Actuals FY05	Actuals FY06	FY06 Actual % Change from FY05 Act.	Enacted Budget FY 2007	Enacted % Change from FY06	Current (Nov-06) Est. FY 2007	Current FY07 % Change from FY06	Current (Nov-06) Est. FY 2008	Current FY08 % Change from Current FY07
Individual Income	\$2,973.0	\$3,689.5	24.1%	\$3,695.2	0.2%	\$3,857.0	4.5%	\$3,930.3	1.9%
Corporate Income	701.9	874.2	24.6%	901.7	3.1%	959.2	9.7%	982.0	2.4%
Sales (TPT)	3,661.2	4,273.4	16.7%	4,628.6	8.3%	4,615.0	8.0%	4,976.0	7.8%
General Property	26.6	25.0		23.0		23.4		21.0	
Luxury	64.7	66.7		67.5		68.0		67.4	
Insurance Premium	358.8	373.7		394.4		393.6		415.9	
Estate	31.2	11.7		0.2		(1.0)		0.0	
Other	1.3	2.8		0.8		2.9		3.0	
TOTAL TAXES	\$7,818.5	\$9,317.1	19.2%	\$9,711.2	4.2%	\$9,918.1	6.5%	\$10,395.6	4.8%
Urban Revenue Sharing (URS)	(\$373.1)	(\$425.2)		(\$551.2)		(\$551.2)		(\$684.6)	
TOTAL TAXES NET URS	\$7,445.4	\$8,891.8	19.4%	\$9,160.0	3.0%	\$9,366.9	5.3%	\$9,711.0	3.7%
NON-TAX REVENUES									
LF & P, SS, Misc and Alt Fuels	\$136.8	\$131.9		\$140.8		\$136.9		\$143.0	
Interest	32.7	74.3		65.0		68.5		40.0	
Lottery	36.1	45.7		50.1		40.0		40.0	
Transfers & Reimbursements	36.2	51.4		51.5		47.5		41.8	
TOTAL NON-TAX REVENUES	\$241.7	\$303.3		\$307.4		\$292.9		\$264.8	
TAX AND NON-TAX REVENUES	\$7,687.1	\$9,195.2	19.6%	\$9,467.4	3.0%	\$9,659.8	5.1%	\$9,975.9	3.3%
Disproportionate Share	\$112.0	\$108.0		\$113.1		\$113.1		\$113.1	
BASE REVENUES	\$7,799.1	\$9,303.2	19.3%	\$9,580.5	3.0%	\$9,772.9	5.0%	\$10,089.0	3.2%
Corporate Tuition tax credits				(10.0)		(10.0)		(12.0)	
Motion Picture tax credits				(9.2)		(9.2)		(10.5)	
Health Insurance Premium tax credits				(3.2)		(3.2)		(6.8)	
Other adjustments				(3.8)		(3.8)		(2.3)	
TOTAL ONGOING REVENUES	7,799.1	9,303.2	19.3%	9,554.4	2.7%	9,746.8	4.8%	10,057.4	3.2%
Legislated Changes-One-time+	157.4	10.0		(58.8)		(58.8)		(55.0)	
TOTAL ALL REVENUES	<u>7,956.6</u>	<u>9,313.2</u>	17.0%	<u>9,495.6</u>	2.0%	<u>9,688.0</u>	4.0%	<u>10,002.4</u>	3.2%
Column Calculation:			(2)/(1)		(4)/(2)		(6)/(2)		(8)/(6)

+ FY 07 one-time revenue change: \$(55.2) million for TPT threshold adjustment, \$(4) million for corporate consolidated credit, +\$.4M liquor license fee
FY 08 one-time revenue change: corporate consolidated credit, estimated \$(55)M - this is the last payment as of Laws 1994, Chapter 41.

Section 3

Guiding Principles

GUIDING PRINCIPLES FOR THE FY 2008 BUDGET

- Construct a fiscally prudent, balanced budget that does not raise taxes, maximizes the efficient use of the State's resources and limits exposure to adverse turns in the economy.
- Focus on making necessary capital investments in infrastructure, such as transportation, education, universities, science and technology, healthcare and water supplies to meet the needs of the nation's fastest growing state.
- Match the timing of benefits received from major capital investments to the payments for those investments, and where practicable, align specific resources with service delivery and benefits.
- Reinforce our commitment to education, strengthening families, economic development, preservation of natural resources, and securing our borders.
- Maintain and build our savings account by ensuring that the Rainy Day Fund (Budget Stabilization Fund) is fully funded.
- Provide targeted salary adjustments for employees in positions where current salaries are not competitive, and provide a general salary adjustment to compensate for changes in cost of living for all employees.
- Recognize that investments in human capital are necessary to equip our children to compete in their chosen occupation in the knowledge-based economy of the twenty-first century.
- Integrate the enhanced performance and efficiency of State agencies and encourage agencies to reduce costs.
- Ensure that the growth in state General Fund spending doesn't exceed the growth of the economy as measured by personal income growth.

Section 4

Operating Budget

STATE OF ARIZONA
SOURCES AND USES OF FUNDS
GENERAL FUND
(In Thousands)

	FY 2006	FY 2007	FY 2008 Executive
	Actual	Estimated	Recommendation
SOURCES OF FUNDS			
Balance Forward	638,989.0	1,074,935.1	421,651.1
Base Revenues	9,728,393.3	10,239,251.9	10,686,941.3
<i>Urban Revenue Sharing</i>	(425,228.9)	(551,230.7)	(684,559.6)
Adjusted Base Revenues	9,303,164.4	9,688,021.2	10,002,381.7
SFB Building Renewal Transfer 1/	(60,080.5)	60,080.5	
Enacted Fund Transfers	10,000.0	-	-
Ladewig Refunds	(48,722.1)	(94,800.1)	-
TOTAL SOURCES OF FUNDS	9,843,350.9	10,728,236.7	10,424,032.8

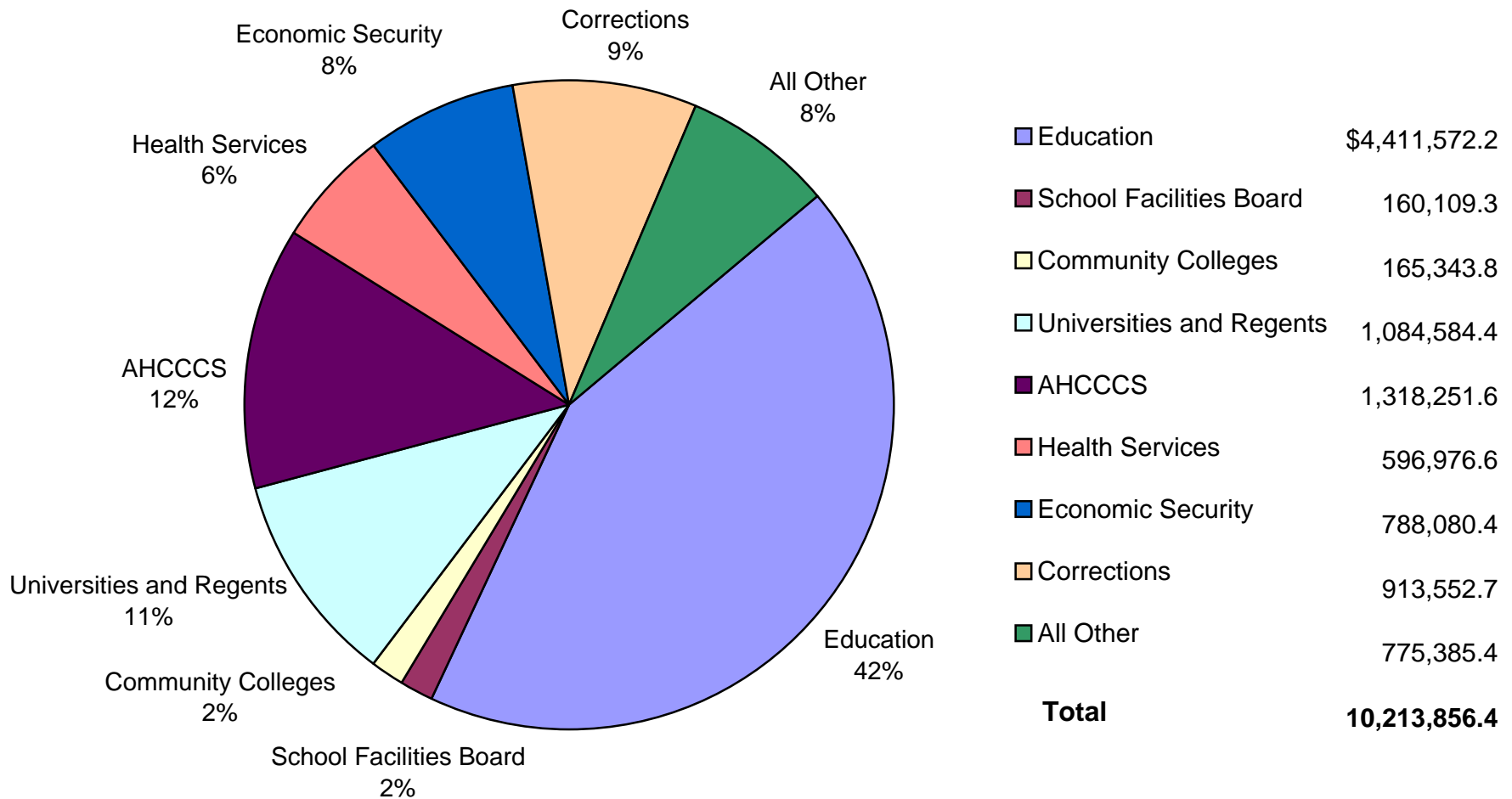
USES OF FUNDS			
Operating Budgets	8,193,160.7	9,392,796.0	10,006,430.0
Operating Budget Supplementals	33,633.7	45,245.4	
Teacher Pay		55,000.0	50,000.0
Teacher Retirement Hold Harmless		45,000.0	18,750.0
Healthcare for Children			5,951.4
Cont. Teacher Education and Performance Pay			4,000.0
Master Teacher			4,000.0
Convert Testing Programs/End-of-course Testing			8,500.0
Math & Science Initiative			15,500.0
Phoenix Biomedical Campus	7,000.0	7,000.0	25,000.0
Retention - Student & Faculty			29,800.0
Arizona Financial Aid Trust	2,100.0	5,000.0	6,300.0
Research Buildings			34,625.0
Greater AZ Dev. Authority (GADA) Enhancement			5,000.0
Science Foundation Arizona 2/		35,000.0	35,000.0
State Employee Compensation	39,900.0	129,700.0	69,654.4
Employer Retirement Contribution	10,000.0	27,635.5	10,000.0
Employee Health Insurance		28,695.9	20,245.0
Payback K-12 Rollover 2/		191,000.0	
Transfer to Rainy Day Fund (Budget Stabilization)	480,957.9	9,808.6	
Other State Agencies Adjustments/Expenditure		29,350.0	8,606.7
Total Operating Budgets	8,766,752.3	10,001,231.4	10,357,362.5
Building Renewal and Capital Outlay	17,150.0	80,354.2	29,295.6
Highway Construction		245,000.0	***
Administrative Adjustments	74,338.0	70,000.0	35,000.0
Reversions	(89,824.5)	(90,000.0)	(60,000.0)
USES OF FUNDS	8,768,415.8	10,306,585.6	10,361,658.1
ENDING BALANCE	1,074,935.1	421,651.1	62,374.7
TOTAL USES OF FUNDS	9,843,350.9	10,728,236.7	10,424,032.8

*** In FY08, the Executive recommendation includes \$500 million in bond financing which creates more than \$400 million in net new funds available to accelerate highway construction by expanding bond maturity limit from 20 to 30 years.

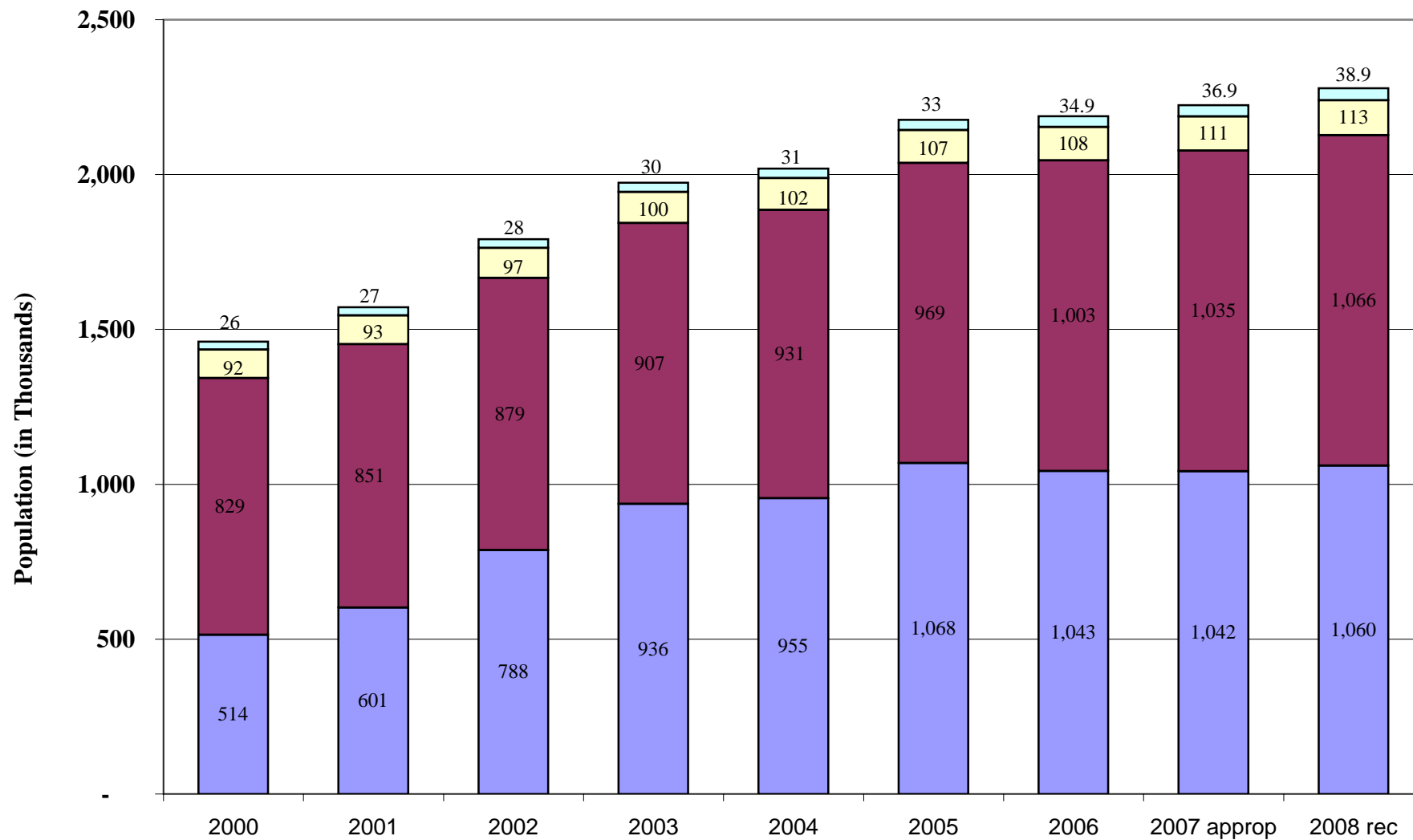
1/ In FY06, School Facilities Board transferred \$60 million more from the General Fund to its building renewal fund than it's entitled to. The adjustment transfer was not made in FY06, but was done in FY07.

2/ \$191M K-12 Rollover and \$35M AZ Science Foundation were recorded as FY06 appropriations, but did not occur in FY06 as intended by the legislation since the effective date of the appropriation was beyond the end of FY06. Therefore these amounts are shown in FY07.

FY 2008 General Fund Executive Budget Recommendation

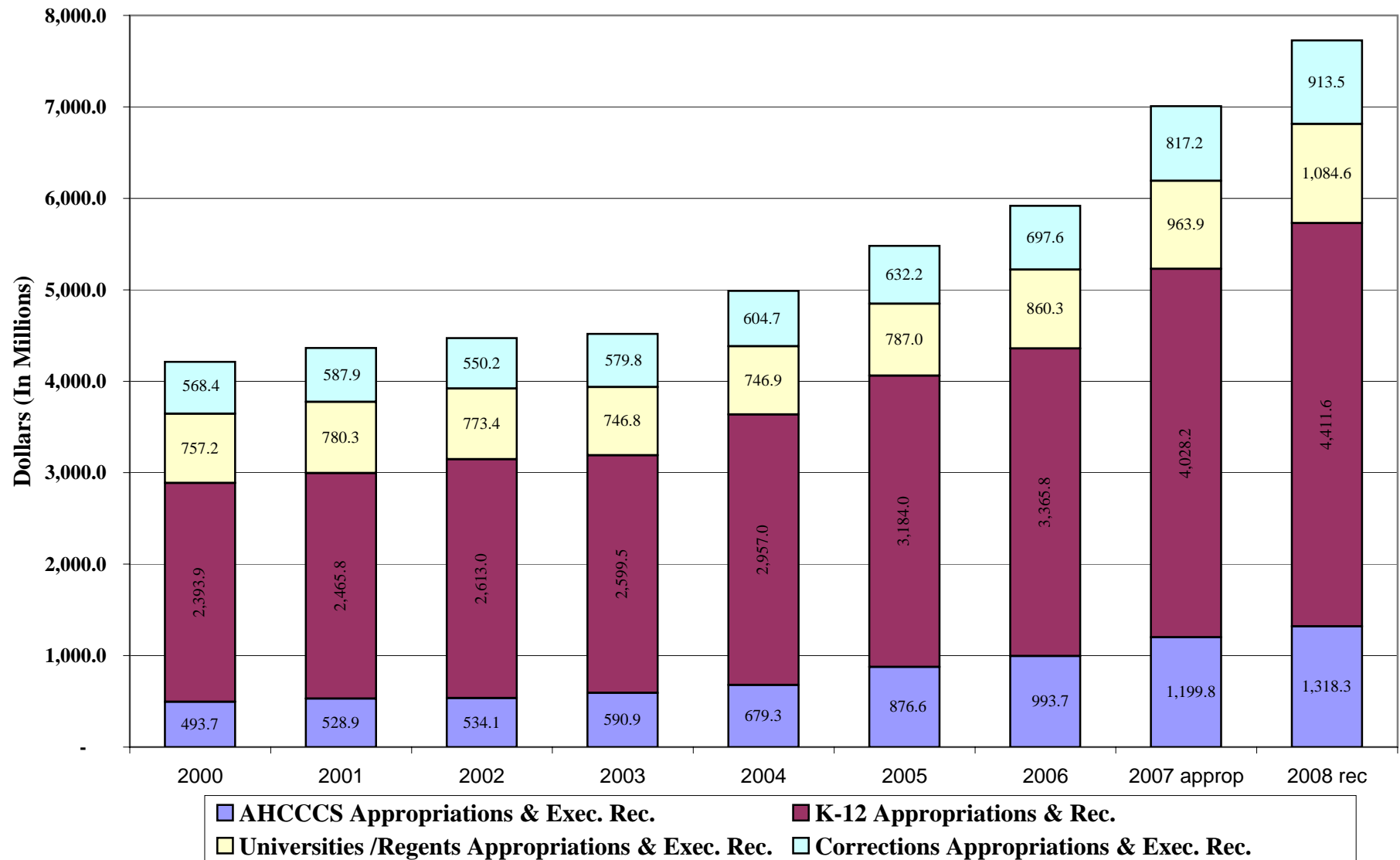


Caseload & Enrollment Populations



■ AHCCCS Caseload
 ■ K-12 Enrollment
 ■ University Enrollment
 ■ Inmate population

General Fund Appropriations for Caseload & Enrollment



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Categories for Budget Depiction

1. Caseload and Inflation

Caseload changes are due to an increasing or decreasing number of customers and assume no FY 2008 changes to the FY 2007 level of service for customers.

Inflation refers to changes in unit cost for an expenditure item in FY 2008 compared to FY 2007. Inflationary increases can include things like the annual price adjustments in the contracts for independent service providers, the cost of utilities, and the price of food.

2. Debt Repayment

Repayment of debt includes any lease-purchase payments for capital or equipment. There may also be instances where money from a fund, not normally used for general state expenditures, was used to cover state operating or capital needs during the recession and is now being repaid by the General Fund or some other funding source.

3. Unfunded Federal and Court Mandates

These include mandates from any court and from changes to Federal law or requirements imposed by Federal agencies. These also include backfilling for cuts on Federal spending, such as Department of Economic Security's loss of federal funds related to the Deficit Reduction Act, including non-reimbursed kinship-care foster homes and child support enforcement.

4. Legislative/Statutory Mandates

Permanent changes to Arizona Revised Statutes or temporary session laws may be accompanied by funding in the legislation making the changes. If the funding was not provided or is insufficient, a budget recommendation could follow.

5. Extension of Existing Program

Increasing the type of customers that participate in an activity or increasing the type of services provided to customers; expanding the scope or range of an existing program or activity.

6. New Initiatives

New services or activities not related to expanding existing programs.

7. Technical and Other Adjustments

These include rent, insurance premiums, changes to existing employee-benefit costs, and backing out one-time costs (for such things as equipment).

8. Employee Compensation

The category includes anything that affects employee pay, including changes that affect the level of employee benefits.

General Fund Operating Budgets Summary

	FY 2006 Expendi- tures	FY 2007 Appro- priation	FY 2008 Changes and Adjustments	FY 2008 Executive Budget	FY 2009 Changes and Adjustments	FY 2009 Executive Budget
<u>Education</u>						
Arizona Commission on the Arts	3,847.7	8,888.1	(6,759.9)	2,128.2	(6,799.9)	2,088.2
ASU - Polytechnic	15,811.7	19,980.9	3,305.3	23,286.2	N/A	N/A
ASU - Tempe	307,911.9	354,043.3	49,321.6	403,364.9	N/A	N/A
ASU - West	44,844.3	49,095.8	1,442.8	50,538.6	N/A	N/A
State Board for Charter Schools	720.1	785.1	572.4	1,357.5	260.1	1,045.2
Arizona Community Colleges	152,325.7	165,536.6	(185.8)	165,350.8	N/A	N/A
Arizona State Schools for the Deaf and the Blind	16,766.4	21,260.9	(147.4)	21,113.5	(1,391.0)	19,869.9
Department of Education	3,365,828.0	4,028,165.6	383,406.6	4,411,572.2	N/A	N/A
Arizona Historical Society	4,114.6	4,337.0	44.5	4,381.5	48.5	4,385.5
Board of Medical Student Loans	323.1	1,500.0	0.0	1,500.0	0.0	1,500.0
Northern Arizona University	124,506.4	135,949.4	19,858.7	155,808.1	N/A	N/A
Commission for Postsecondary Education	1,391.3	6,620.8	0.0	6,620.8	0.0	6,620.8
Prescott Historical Society of Arizona	652.7	750.4	50.1	800.5	50.1	800.5
Arizona Board of Regents	6,814.7	14,904.1	6,848.0	21,752.1	N/A	N/A
School Facilities Board	52,401.1	413,764.2	(253,654.9)	160,109.3	N/A	N/A
University of Arizona - Health Sciences Center	64,261.3	69,098.5	10,928.6	80,027.1	N/A	N/A
University of Arizona - Main Campus	293,785.2	320,798.1	29,009.3	349,807.4	N/A	N/A
Education Total	4,456,306.2	5,615,478.8	244,039.9	5,859,518.7	(7,832.2)	36,310.1
<u>Protection and Safety</u>						
Department of Corrections	707,715.4	817,157.7	96,395.0	913,552.7	N/A	N/A
Arizona Criminal Justice Commission	1,118.0	4,302.0	0.0	4,302.0	0.0	4,302.0
Department of Emergency Services and Military Affairs	10,309.5	14,394.1	(379.2)	14,014.9	(379.2)	14,014.9
Board of Executive Clemency	919.3	1,067.9	30.9	1,098.8	30.9	1,098.8
Department of Homeland Security	0.0	0.0	486.3	486.3	486.3	486.3
Department of Juvenile Corrections	70,562.5	79,848.3	301.3	80,149.6	N/A	N/A
Law Enforcement Merit System Council	70.8	76.4	0.2	76.6	0.2	76.6
Department of Public Safety	41,751.2	166,196.6	(78,346.0)	87,850.6	10,909.3	177,105.9
Department of Transportation	76.4	82.9	0.0	82.9	N/A	N/A
Protection and Safety Total	832,523.1	1,083,125.9	18,488.5	1,101,614.4	11,047.5	197,084.5
<u>Health and Welfare</u>						
Arizona Health Care Cost Containment System	993,730.6	1,199,768.0	118,483.6	1,318,251.6	N/A	N/A
Department of Economic Security	623,932.0	718,950.2	68,978.3	787,928.5	N/A	N/A
Department of Environmental Quality	13,493.3	32,295.7	1,562.4	33,858.1	1,545.4	33,841.1
Department of Health Services	476,671.4	549,247.6	47,729.0	596,976.6	N/A	N/A
Arizona Pioneers' Home	0.0	1,280.9	(43.3)	1,237.6	(43.3)	1,237.6
Department of Veterans' Services	2,372.0	4,149.7	1,336.7	5,486.4	1,257.1	5,406.8
Health and Welfare Total	2,110,199.3	2,505,692.1	238,046.7	2,743,738.8	2,759.2	40,485.5
<u>Natural Resources</u>						
Arizona Game & Fish Department	0.0	3,500.0	(3,500.0)	0.0	(3,500.0)	N/A
Arizona Geological Survey	825.1	1,106.1	164.6	1,270.7	198.3	1,304.4
State Land Department	22,777.6	26,435.4	940.8	27,376.2	972.5	27,407.9
Department of Mines and Mineral Resources	798.8	843.9	106.3	950.2	106.3	950.2
Arizona Navigable Stream Adjudication Commission	164.9	267.8	(92.1)	175.7	(267.7)	0.1
State Parks Board	22,526.6	27,040.3	1,577.5	28,617.8	4,577.5	31,617.8
Department of Water Resources	18,898.9	20,877.8	4,518.8	25,396.6	4,513.0	25,390.8
Natural Resources Total	65,991.9	80,071.3	3,715.9	83,787.2	6,599.9	86,671.2

<u>Inspection & Regulation</u>	FY 2006	FY 2007	FY 2008	FY 2008	FY 2009	FY 2009
	Expenditures	Appropriation	Changes and Adjustments	Executive Budget	Changes and Adjustments	Executive Budget
Arizona Department of Agriculture	10,715.0	11,369.6	1,022.1	12,391.7	1,285.4	12,655.0
Corporation Commission	5,212.9	5,543.2	(6.3)	5,536.9	(6.3)	5,536.9
State Department of Financial Institutions	3,309.5	3,733.9	241.8	3,975.7	269.3	4,003.2
Department of Fire, Building and Life Safety	3,187.4	3,625.5	153.9	3,779.4	116.5	3,742.0
Department of Insurance	6,635.5	7,172.8	1.9	7,174.7	1.9	7,174.7
Department of Liquor Licenses and Control	2,923.9	4,813.1	(1,256.3)	3,556.8	(1,276.3)	3,536.8
State Mine Inspector	1,161.9	1,226.7	(83.2)	1,143.5	(106.6)	1,120.1
State Board of Nursing	163.4	166.0	0.0	166.0	0.0	166.0
OSHA Review Board	2.7	0.0	0.0	0.0	N/A	N/A
State Board of Podiatry Examiners	0.0	0.0	0.0	0.0	N/A	N/A
Arizona Department of Racing	2,606.8	2,750.7	183.8	2,934.5	153.7	2,904.4
Radiation Regulatory Agency	1,140.4	1,530.9	163.1	1,694.0	125.2	1,656.1
Department of Real Estate	3,694.4	3,986.7	435.8	4,422.5	511.3	4,498.0
Department of Weights and Measures	1,590.0	1,649.8	(0.2)	1,649.6	(24.9)	1,624.9
Inspection & Regulation Total	42,343.8	47,568.9	856.4	48,425.3	1,049.2	48,618.1

<u>General Government</u>	FY 2006	FY 2007	FY 2008	FY 2008	FY 2009	FY 2009
	Expenditures	Appropriation	Changes and Adjustments	Executive Budget	Changes and Adjustments	Executive Budget
Arizona Department of Administration	34,379.8	27,559.7	4,404.9	31,964.6	N/A	N/A
Office of Administrative Hearings	1,151.8	1,214.6	(0.9)	1,213.7	(0.9)	1,213.7
Attorney General - Department of Law	25,209.8	22,495.5	124.0	22,619.5	(1,123.5)	21,372.0
Auditor General	12,551.0	17,891.9	0.0	17,891.9	0.0	17,891.9
State Capital Post-Conviction Public Defender Office	0.0	220.0	501.7	721.7	501.7	721.7
Department of Commerce	8,560.1	11,983.7	8,831.6	20,815.3	8,829.6	20,813.3
Governor's Office for Equal Opportunity	227.4	245.7	1.0	246.7	1.0	246.7
State Board of Equalization	574.6	653.5	(2.4)	651.1	(0.7)	652.8
Government Information Technology Agency	0.0	1,500.0	1,795.3	3,295.3	4,231.1	5,731.1
Office of the Governor	6,101.8	6,634.8	0.0	6,634.8	0.0	6,634.8
House of Representatives	10,690.1	13,354.8	0.0	13,354.8	0.0	13,354.8
Arizona Commission of Indian Affairs	204.1	224.4	153.1	377.5	153.1	377.5
Joint Legislative Budget Committee	1,152.9	2,949.0	0.0	2,949.0	0.0	2,949.0
Judiciary	118,238.4	125,025.6	(0.2)	125,025.4	N/A	N/A
Legislative Council	4,994.0	8,076.2	0.0	8,076.2	0.0	8,076.2
Arizona State Library, Archives & Public Records	7,064.6	7,540.6	200.0	7,740.6	0.0	7,540.6
Personnel Board	301.9	358.1	0.5	358.6	0.5	358.6
Arizona Rangers' Pension	12.8	13.0	0.4	13.4	0.7	13.7
Department of Revenue	65,534.1	71,856.1	921.5	72,777.6	(773.7)	71,082.4
Department of State - Secretary of State	3,026.4	7,074.0	(133.8)	6,940.2	3,224.6	10,298.6
Senate	7,620.0	8,693.0	0.0	8,693.0	0.0	8,693.0
Governor's Office of Strategic Planning and Budgeting	2,096.5	2,211.1	0.0	2,211.1	0.0	2,211.1
State Board of Tax Appeals	276.1	307.5	1.6	309.1	2.5	310.0
Arizona Office of Tourism	10,517.9	14,986.0	592.8	15,578.8	864.5	15,850.5
State Treasurer	4,976.9	5,769.3	486.0	6,255.3	334.7	6,104.0
Commission on Uniform State Laws	44.8	52.3	4.5	56.8	5.5	57.8
General Government Total	325,507.8	358,890.4	17,881.6	376,772.0	16,250.7	222,555.8
General Fund Operating Total	7,832,872.1	9,690,827.4	523,029.0	10,213,856.4	29,874.3	631,725.2

EFFICIENCY REVIEW SAVINGS AND COST AVOIDANCES

Efficiency Review Initiatives – Five-Year Summary

(In-thousands)

Statewide Initiatives	FY 04 Actual	FY 05 Actual	FY 06 Actual	FY 07 OSP Est.	FY 08 OSP Est.	Five-Year Total
Employee Benefits	0.0	0.0	25,000.0	48,000.0	59,000.0	130,000.0
Energy Conservation	0.0	442.8	205.0	205.0	205.0	1,057.8
Leasing / Space Utilization	0.0	1,543.0	1,200.0	0.0	0.0	2,743.0
Fleet Consolidation	0.0	922.0	1,074.9	922.0	922.0	3,840.9
Statewide E-Procurement	0.0	15,700.0	22,295.0	45,000.0	45,000.0	127,995.0
Total for Statewide Initiatives	0.0	18,607.8	49,774.9	94,127.0	105,127.0	267,636.7
Total for Agency Specific Initiatives	31,394.5	91,341.5	170,851.4	99,313.5	107,998.4	500,899.3
Total for All Initiatives	31,394.5	109,949.3	220,626.3	193,440.5	213,125.4	768,536.0

In January 2003, the State faced serious fiscal challenges that required bold and creative solutions. State revenues had been in decline for some time, and State agencies were struggling to maintain programs and meet growing service demands. As part of her plan to cope with the fiscal crisis, Governor Napolitano established the Efficiency Review (ER) initiative, which ultimately challenged all executive agencies to find sensible ways to save money and reduce costs without harming programs and services.

FINANCIAL SUCCESS - According to data compiled by OSPB, agency-specific and statewide projects developed through ER will save an estimated \$213 million in FY 2008. By the end of the current fiscal year, cumulative project savings since FY 2004 are expected to total almost \$768.5 million.

Statewide initiatives continued to produce savings in FY 2006 and are projected to contribute approximately \$105.1 million in FY 2008.

Agency-specific savings. Agencies continue to be challenged to create annual savings plans that produce new ideas for efficiency savings on an annual basis. While all projects may not yet be implemented, ideas for agency-specific efficiency savings in FY 2008 total \$108 million.

If an initiative is a cost *avoidance* – i.e., a permanent or long-term savings – it is accounted for in each year of the five-year plan in which the avoidance applies. If an initiative is a cost *savings* – i.e., a temporary or short-term savings – it is accounted for in the year(s) to which it applies. Many of the ER projects reported for FY 2008 include the following themes:

Technology. Agencies have used innovation and technology to convert paper processes to forms of electronic communication. Several agencies are now completing license renewals on-line, and many are converting mailings for items such as reports, newsletters and various other documents to Internet formats for public viewing.

Human resources. Several agencies have increased the number of volunteers and volunteer hours to alleviate some of the pressures caused by a lack of funding for additional staff.

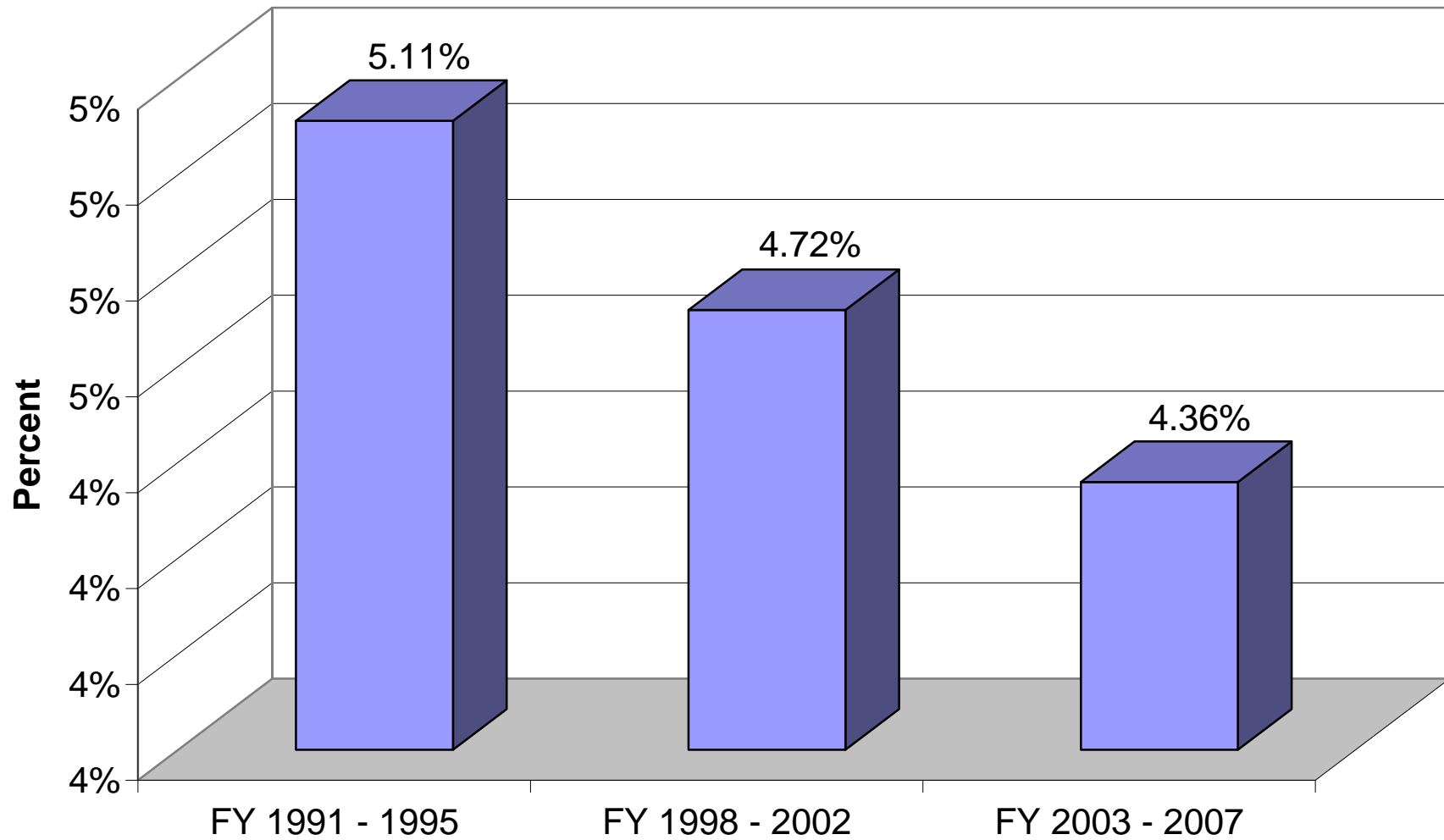
Red tape reduction. Process streamlining has also been able to achieve savings. While some agencies have consolidated the number of required forms by reducing duplicative questions, others have also been conducting process reviews and have been able to eliminate unnecessary steps.

Redeployment of savings. Agencies continue to report how they redeployed savings in FY 2006 and their expected redeployment for FYs2007 and 2008. Most agencies redeploy their savings to cover the increasing costs of operations.

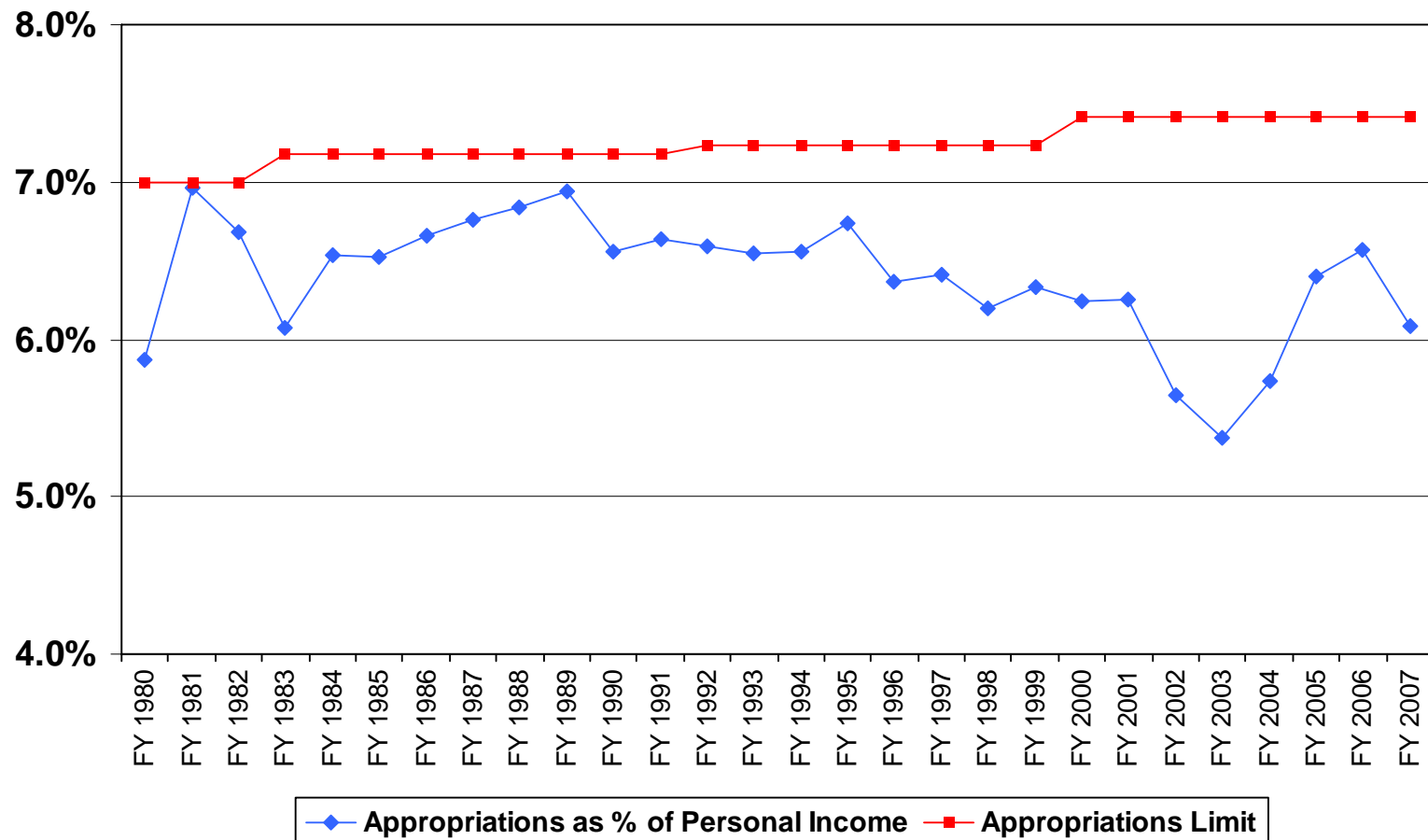
Section 5

Balanced Budget

General Fund Operating Appropriations as a Percentage of Total Personal Income - 5 Year Average



Arizona Actual Appropriations vs. Appropriations Limit



Source: Joint Legislative Budget Committee

(Dollars in Millions)

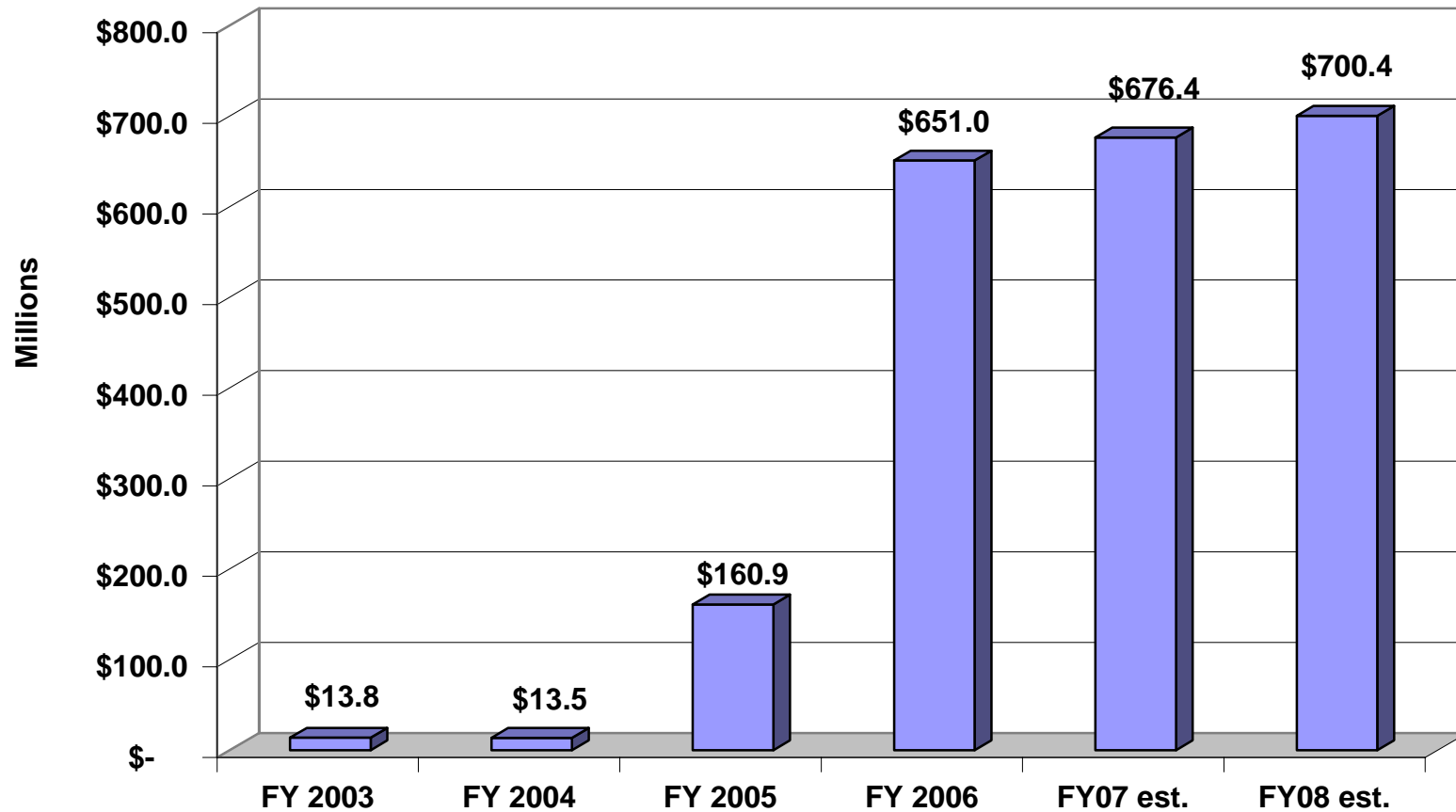
OSP and JLBC GF Ending Balance Estimates 6 Months Prior to Fiscal Year End

	January 2003 OSP Estimate for June 30, 2003	January 2003 JLBC Estimate for June 30, 2003	June 30, 2003 Actual
FY 2003	61.2	60.1	192.2
	January 2004 OSP Estimate for June 30, 2004	January 2004 JLBC Estimate for June 30, 2004	June 30, 2004 Actual
FY 2004	173.0	178.7	360.4
	January 2005 OSP Estimate for June 30, 2005	January 2005 JLBC Estimate for June 30, 2005	June 30, 2005 Actual
FY 2005	143.8	141.0	639.0
	January 2006 OSP Estimate for June 30, 2006	January 2006 JLBC Estimate for June 30, 2006	June 30, 2006 Actual
FY 2006	1,047.0	610.2	1,074.9
	January 2007 OSP Estimate for June 30, 2007	January 2007 JLBC Estimate for June 30, 2007	June 30, 2007 Actual
FY 2007	421.7	Not Yet Available	Not Yet Available

OSP and JLBC GF Ending Balance Estimates 18 Months Prior to Fiscal Year End

	January 2003 OSP Estimate for June 30, 2004	January 2003 JLBC Estimate for June 30, 2004	June 30, 2004 Actual
FY 2004	2.4	56.5	360.4
	January 2004 OSP Estimate for June 30, 2005	January 2004 JLBC Estimate for June 30, 2005	June 30, 2005 Actual
FY 2005	66.8	(332.7)	639.0
	January 2005 OSP Estimate for June 30, 2006	January 2005 JLBC Estimate for June 30, 2006	June 30, 2006 Actual
FY 2006	7.4	(476.7)	1,074.9
	January 2006 OSP Estimate for June 30, 2007	January 2006 JLBC Estimate for June 30, 2007	June 30, 2007 Actual
FY 2007	24.7	1.0	Not Yet Available
	January 2007 OSP Estimate for June 30, 2008	January 2007 JLBC Estimate for June 30, 2008	June 30, 2008 Actual
FY 2008	62.4	Not Yet Available	Not Yet Available

Rainy Day Fund Balance (Budget Stabilization Fund)



Source: FY 2003 - 2005: JLBC Appropriations Report. FY 2006: General Accounting Office. FY 2007 - 2008: OSPB estimates of Rainy Day Fund (BSF) ending balance to fulfill the statutory cap, assuming 5% interest rate earnings on the BSF.

Structural Balance: a Theoretical Concept of Little Practical Use

Definition of Structural Balance

- The theory of a structural balance is based on a forecast and analysis of expenditures and revenues, which distinguishes between one-time and continuing expenditures and revenues
- Continuing revenues include revenue sources such as: income taxes, transaction privilege taxes, and continuing non-tax revenues, such as lottery revenues and interest earnings.
- One-time revenues include sources such as one-time transfer payments from the federal government. Although balance surpluses that carry over from the previous year are considered one-time revenue by JIBC, these balances are created by unanticipated continuing revenue sources and are appropriately categorized as continuing revenues.
- Continuing expenditures include expenditures such as formula-based expenditures that incorporate additional spending for caseload growth and statutorily-prescribed expenditures that continue beyond the budget period.
- One-time expenditures are those that are made only in the budget period and do not carry-forward in subsequent years. An expenditure for a special item of equipment that is made only once would be an example.
- The misdirected notion of the existence of a structural deficit states that if the projection of “continuing revenues” is lower than the projection of “continuing expenditures”, a structural deficit, or shortfall results.

Why the Theoretical Concept of Structural Balance has Limited or No Value in Directing the State Budget

- First and foremost, state law effectively requires the Executive to submit a budget that is balanced. That is, in each and every budget submission, the Governor must propose a budget wherein revenues and expenditures are in balance and that does not result in a shortfall or negative balance, *regardless of prior years’ appropriations or expenditure levels*.
- In short, the Executive budget in each and every year *must* fit all proposed appropriations or expenditures for each proposed budget within the available resources or revenues for the budget year.
- Second, the concept of structural balance requires that continuing expenditures and revenues be categorized accurately. Disputes will inevitably arise over whether revenues or expenditures are one-time or continuing. For instance the dispute over the balance carry-forward.
 - **The balance carry-forward should be identified as a continuing revenue, since it exists every year and results, in part, from continuing revenues generated in the previous year.**
- Third, by its very definition, the structural balance is a forecasting concept and forecasts are fraught with inaccuracies and uncertainties. Projections of revenues in each of the past three enacted budgets have fallen short of actual revenue collections by 17 percent. *This bias leads to a tendency to identify structural deficits where none exist*. The inability to accurately forecast revenues and expenditures renders the structural balance analysis of little practical use.

Section 6

Capital Budget

**FINANCING STRATEGIES
CAPITAL OUTLAY BUDGET**

REVITALIZATION AND INFRASTRUCTURE DEVELOPMENT

SCHOOL FACILITIES BOARD

New School Construction, School Facilities Board – The Executive recommendation supports \$407.7 million for statewide construction of new schools to be financed through a lease-to-own financing mechanism. These monies will be used to build approximately 29 elementary and middle schools the average size of 750 students and 7 high schools the average size of 1,500 students. The lease-to-own mechanism will ensure that adequate funding will be available to meet construction needs of eligible school districts, provide capital resources for Full-Day Kindergarten, and implement LEED (Leadership in Energy Efficient Design) or other Board approved energy and environmental design standards in new school construction projects.

STATE TRANSPORTATION BOARD

State Highway Revenue Bond, Department of Transportation – The Executive proposal includes a statutory amendment to authorize the State Transportation Board to issue Highway Revenue bonds with maturity of up to 30 years. Several states have successfully implemented this measure. Currently bond maturities are limited to 20 years. Upon approval, this initiative will enable the Transportation Board to leverage about \$500 million, which creates more than \$400 million in net new funds available to accelerate highway construction.

Increased population growth and geographic dispersion require more strategic expansion of our transportation system capacity and more effective solutions. Acceleration and strategic expansion of our system capacity and other solutions are needed to address our growing mobility needs. Present and future traffic congestion cannot be relieved without significant investment in the transportation infrastructure and ways of managing and maintaining such public assets.

During the upcoming legislative session, cooperative efforts will be needed to ensure that additional financing measures be approved in order to enable the State Transportation Board to speed up highway construction projects and help address our transportation needs in the Valley and around the state.

BOARD OF REGENTS BUILDING SYSTEM

College of Construction, Arizona State University – The Executive recommends \$1.5 million debt service payments on \$20 million in new 15-year Certificates of Participation (COPs) to support designing and building the Arizona State University (ASU) College of Construction, as part of the One Arizona Initiative. The recommended funding is the State's share in this project. Other public and private endowment entities will contribute at least another \$20 million to complement this legislative appropriation and establish the new College of Construction.

Surveys have identified that skilled labor shortage is a primary reason for project delays and cost increases. To mitigate this factor and enable our local universities to educate and train the future managers of construction, stakeholders representing research, education and construction entities are partnering to establish a world-class program that is focused on construction and associated innovation techniques and disciplines – the ASU College of Construction. The College of Construction will aim at improving the productivity and cost effectiveness of the design and construction industries.

The new facility will consist of 75,000 square feet, including 15,000 square feet for teaching and research laboratory space, six classrooms to offer construction management courses for bachelors, masters and doctoral programs that will allow 1,000 students to enroll.

ADOA BUILDING SYSTEM

New Forensic Hospital, Department of Health Services – The current Arizona State Hospital wing, designated as the Forensic Unit, is housed in a 50-year old building that no longer meets the needs or standards for patients and staff in a healthcare facility. Due to the age and condition of the current structure, it is not cost-effective to renovate the building as a forensic unit that would meet security and health standards. The Executive recommends funding for demolition and construction of a new Forensic Unit at ASH to provide functional and secured facility for forensic patients and their health providers. The project is estimated at \$32.2 million.

Water/Sewer Infrastructure, Department of Corrections – The Recommendation includes \$6.8 million to construct water and sewage treatment plants and water storage facilities at the Tucson, Lewis, Winslow/Apache, and Douglas prison complexes. The untreated groundwater is deteriorating pipes, water heaters, evaporative coolers and other system components. The current plant is outdated and non-compliant with environmental standards and constitutes a health risk to persons inside and outside of the prison. This situation presents a substantial liability to the State and continues to pose a public health risk.

Capitol Mall Modernization and Renovation, Department of Administration (ADOA) – The Executive recommends \$40 million to begin implementing core components identified in the Capitol Mall Centennial Plan, including the renovation and modernization of the old State health laboratory that is presently not fully utilized. Additionally, funding is recommended to design and develop the core area of the Capitol Mall to align it with Arizona’s history and its vision for the future. This initiative reflects efforts from various public and private entities. As envisioned in the Plan, the Capitol Mall will feature a series of sustainable connective infrastructures that make public spaces and services more accessible and facilitate more effective governance.

Investment Projects, ADOA System – \$7.4 million from the General Fund is recommended for FY 2008 debt service payments on \$76.8 million in new, 15-year Certificate of Participation (COP) the above projects.

Highway Revenue Bonds

Comparative Capacities at 20 and 30 Year Maturities

THE CONCEPT – 30 YEAR BONDS:

Currently, ARS § 28-7503 limits the term of HURF bonds to 20 years. The Executive has proposed that this maximum term be extended in statute to 30 years. This proposal was recommended by the Governor's Growth Cabinet.

The concept of issuing 30-year bonds is very similar to one that many homeowners consider when buying a home. If an individual has income that will support a \$1,600 per month mortgage payment, the homeowner would qualify for a 20-year mortgage of about \$220,000. If a mortgage of that size would not buy a home sufficient for the homeowner's needs, one option would be to look at acquiring a 30-year mortgage. For the same \$1,600 per month, the homeowner would now qualify for a mortgage of approximately \$265,000. Taking out a longer mortgage is one option that will allow ADOT to provide the larger "home" (in this case highway capacity), that the state desperately needs in order to accommodate its growing family.

ALIGN PROJECT FUNDING WITH USEFUL LIFE:

Highways are long-lived assets and future generations benefit from highways constructed today. Almost half of the other states that issue bonds for highway purposes have recognized that highways are assets that typically have useful lives will beyond 20 years, and allow bonds to be issued for terms ranging from 25 years to as long as 40 years. Increasing the allowable term for HURF bonds would allow ADOT to more closely match a project's funding source with its useful life, and allow more future users to share in the cost of projects constructed today. We estimate that this statutory change will increase ADOT's allowable bond financing by \$500 million; thereby, creating more than \$400 million in net new funds available to accelerate projects on the State Highway System.

The amount of Highway Revenue Bond capacity currently available to the Department is a function of four variables: the Department's share of HURF funds, coverage levels, interest rates, and the maximum maturity of the bonds (currently 20 years). Based on current conditions, the Department estimates its current maximum bonding capacity at approximately \$2.1 billion.

By increasing the maximum maturity of ADOT's outstanding bonds to 30 years (and assuming no change in any of the other three variables), ADOT's maximum borrowing capacity rises from approximately \$2.1 billion to approximately \$2.6 billion.

EFFECT ON BOND RATINGS:

ADOT's HURF bonds are highly rated by the two major rating agencies. Senior and subordinate lien HURF bonds are rated "AAA" by Standard & Poors. This is the highest rating category. Senior and subordinate lien bonds are rated "Aa1" and "Aa2" respectively by Moody's Investors Service. ADOT does not expect that changing the maximum allowable term of HURF bonds would impact the ratings on future issues.

MAJOR ECONOMIC BENEFITS:

Paying debt service over a longer term will result in projects being constructed sooner than they otherwise would have been. Although the longer term means that higher amounts in total debt service (interest) will be paid, the motorizing public will realize a significant economic benefit through reduction in the "time tax" – the tax imposed by spending excess time in clogged traffic. In addition, a net present value analysis of the cost of extending the capital financing term from 20 years to 30 years results in a moderate increase in real costs-- especially given the substantial economic benefits to businesses and individuals. Like the example cited above, most homeowners are comfortable with a 30-year mortgage because they realize the additional cost will be more than offset by the future economic benefits of their home. We must view our investment in the state's highway system as an investment in Arizona's economic future.

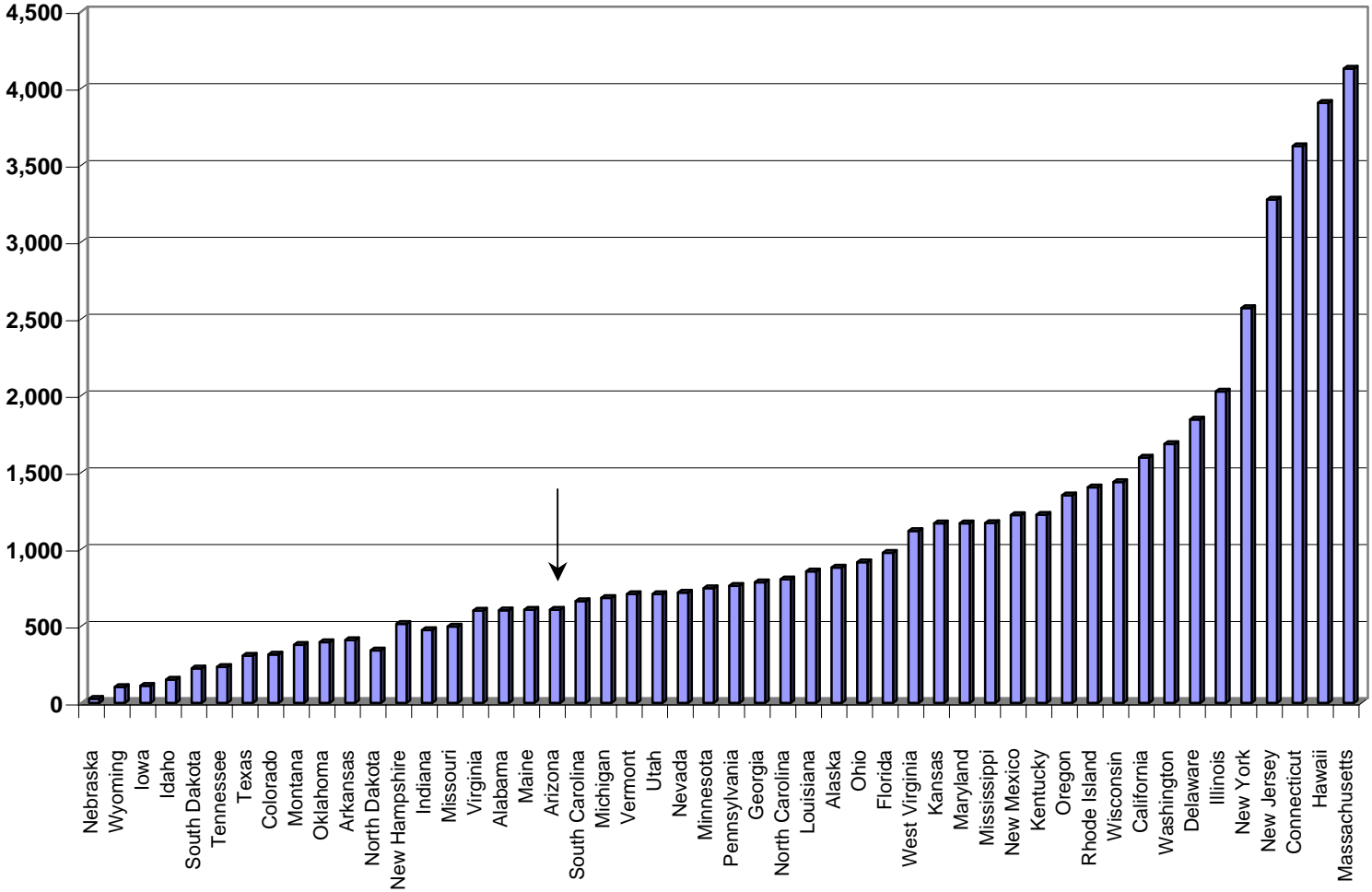
Governor Napolitano's fiscal policies and prudent debt management have resulted in increased and stable credit rating for Arizona. The rating agencies' independent assessment speaks well of the State's fiscal management and the higher credit ratings generate significant savings on State borrowed funds.

Debt Ratings

Rating Service/ Debt Type	2003	2004	2005	2006
<u>Moody's Investors Service</u>				
General State Credit	No Rating	Aa3 Stable Outlook	Aa3 Stable Outlook	Aa3 Stable Outlook
Certificates of Participation	A1 Negative Outlook	A1 Stable Outlook	A1 Stable Outlook	A1 Stable Outlook
<u>Standard & Poor's</u>				
General State Credit	No Rating	AA Stable Outlook	AA Stable Outlook	AA Stable Outlook
Certificates of Participation	AA- Negative Outlook	AA- Stable Outlook	AA- Stable Outlook	AA- Stable Outlook

- Arizona's "AA" level general credit ratings reflect a very strong profile.
- Arizona is judged by Moody's to be of high credit quality and subject to very low credit risk.
- Moody's April 2006 publication ranked Arizona:
 - 32nd in nation in net-tax-supported debt per capita
 - The mean per capita debt of the 50 states was \$1,060 compared to Arizona's \$607
 - 31st in the nation in debt as a percentage of 2005 personal income
 - The mean debt as a percentage of personal income of the 50 states was 3.0% compared to Arizona's 2.0%

2006 Net Tax-Supported Debt Per Capita



Graphical representation was produced from information from Moody's Investors Service of Net Tax-Supported Debt

2006 Net Tax-Supported Debt Per Capita		
1	Massachusetts	4,128
2	Hawaii	3,905
3	Connecticut	3,624
4	New Jersey	3,276
5	New York	2,569
6	Illinois	2,026
7	Delaware	1,845
8	Washington	1,684
9	California	1,597
10	Wisconsin	1,437
11	Rhode Island	1,402
12	Oregon	1,350
13	Kentucky	1,225
14	New Mexico	1,222
15	Mississippi	1,171
16	Maryland	1,169
17	Kansas	1,169
18	West Virginia	1,119
19	Florida	976
20	Ohio	915
21	Alaska	880
22	Louisiana	855
23	North Carolina	804
24	Georgia	784
25	Pennsylvania	762
26	Minnesota	746
27	Nevada	717
28	Utah	707
29	Vermont	707
30	Michigan	683
31	South Carolina	661
32	Arizona	607
33	Maine	606
34	Alabama	603
35	Virginia	601
36	Missouri	496
37	Indiana	474
38	New Hampshire	514
39	North Dakota	342
40	Arkansas	409
41	Oklahoma	395
42	Montana	377
43	Colorado	314
44	Texas	307
45	Tennessee	234
46	South Dakota	225
47	Idaho	152
48	Iowa	110
49	Wyoming	103
50	Nebraska	27
MEAN:		\$1,060
MEDIAN:		\$754
Puerto Rico		\$7,312

* Issuer Rating (No G.O. Debt)
** No General Obligation Debt
*** This figure is not included in any totals, averages, or median calculations but is provided for comparison purposes only.

2006 Net Tax-Supported Debt as a % of 2005 Personal Income		
1	Hawaii	11.3%
2	Massachusetts	9.4%
3	Connecticut	7.6%
4	New Jersey	7.5%
5	New York	6.4%
6	Illinois	5.6%
7	Delaware	5.0%
8	Washington	4.8%
9	Mississippi	4.7%
10	New Mexico	4.4%
11	California	4.3%
12	Kentucky	4.3%
13	Wisconsin	4.3%
14	West Virginia	4.3%
15	Oregon	4.2%
16	Rhode Island	4.0%
17	Kansas	3.5%
18	Louisiana	3.5%
19	Ohio	2.9%
20	Florida	2.9%
21	Maryland	2.8%
22	North Carolina	2.6%
23	Utah	2.6%
24	Georgia	2.5%
25	Alaska	2.5%
26	South Carolina	2.3%
27	Pennsylvania	2.2%
28	Vermont	2.2%
29	Michigan	2.1%
30	Alabama	2.0%
31	Arizona	2.0%
32	Nevada	2.0%
33	Minnesota	2.0%
34	Maine	2.0%
35	Virginia	1.6%
36	Missouri	1.6%
37	Arkansas	1.5%
38	Indiana	1.5%
39	New Hampshire	1.4%
40	Oklahoma	1.3%
41	Montana	1.3%
42	North Dakota	1.1%
43	Texas	0.9%
44	Colorado	0.8%
45	Tennessee	0.8%
46	South Dakota	0.7%
47	Idaho	0.5%
48	Iowa	0.3%
49	Wyoming	0.3%
50	Nebraska	0.1%
MEAN:		3.0%
MEDIAN:		2.3%

** This figure is calculated by using Debt data from Moody's Special Comment April 2006 Edition and Personal Income data from Bureau of Economic Analysis.

Section 7

Executive Initiatives

One Arizona Executive Initiatives for FY 2008 Budget

EDUCATION

Teacher Base Pay

The Executive continues to support teachers and the teaching profession by including several recommendations that serve to recruit and retain quality teachers to Arizona's schools:

- Establishes a minimum base salary of \$33,000 per year and provides additional funding to increase the base salary of teachers at or above the minimum (\$50 million).
- Holds teachers and school districts harmless for the 0.5% retirement increase (\$18.8 million).

Children's Healthcare Initiative

This initiative would provide all children in Arizona with the opportunity to have health insurance. The budget includes \$6 million to reach out to already-eligible-for-KidsCare children to ensure that their families are aware of this opportunity and to expand the current federally-matched program from 200% to 300% of the Federal Poverty Level (FPL).

Continuing Teacher Education & Teacher Performance Pay

The Executive recommends \$4 million in FY 2008 to the State Board of Education to design a statewide system for continuing teacher education and performance pay.

Master Teacher

Master Teacher is a state-funded teacher-mentoring program designed to retain new teachers in the profession and provide leadership opportunities for experienced teachers. The Executive recommends \$4 million in FY 2008 from the General Fund to the State Board of Education for distribution to the K-12 Center at NAU to continue expanding the Master Teacher program statewide through regional partnerships.

Convert Testing Program (AIMS) – End-of-Course Testing/Technology Based Exams

The Executive recommends \$8.5 million from the General Fund in FY 2008 to convert the existing testing system (AIMS) to end-of-course testing and from paper tests to computer tests. The new testing system will allow prompt test results that will enable schools to provide immediate help to students who are underperforming.

Math & Science Initiative

The Executive recommendation includes \$15.5 million to build capacity in math and science education by:

- \$10 million to provide assistance for existing teachers to become highly qualified in math or science by increasing base pay for highly qualified math and science teachers currently teaching in Arizona schools
- \$3 million to provide incentives for university students to become teachers in math and science
- \$2.5 million to award grants to school districts to establish innovative math and science programs and academies

Phoenix Biomedical Campus

Arizona has a shortage of physicians, pharmacists, and many technical and allied health professionals. To address this issue, the FY 2008 Executive Budget includes \$25.0 million to support expanding the capacity of the biomedical education and research programs of the Arizona university system. The recommended resources provide funding for the following:

- \$6.0 million for the University of Arizona College of Medicine –Phoenix Program to expand enrollment capacity and graduate more physicians.
- \$4.0 million for Northern Arizona University to expand health professions programs in Flagstaff and throughout the State.

FY 2008 Executive Initiatives

- \$2.0 million for Arizona State University to increase the teaching capacity of the Biomedical Informatics program.
- \$1.5 million for the University of Arizona College of Pharmacy to start a 4-year doctor of Pharmacy program in Phoenix.
- \$1.0 million for the University of Arizona Telemedicine Program to implement a program in the College of Medicine-Phoenix Program using telemedicine for interdisciplinary education to medical students.
- \$10.5 million split evenly between Arizona State University and the University of Arizona to cover the costs of programming, conceptual, and schematic design for the ABC 2 and Education buildings (one-time).

Retention- Student and Faculty

The Executive recommendation provides \$29.8 million to the universities to increase student and faculty retention. These resources, combined with the Executive's recommended 3.5% increase in employee pay, will provide the universities funding to increase stipends provided to faculty and graduate teaching assistants and associates in order to attract and retain the best faculty and brightest graduate students.

Recruiting and retaining key faculty is crucial for the universities to achieve more course availability and reduce class sizes. By doing this and by adding more advisors, the universities can improve student retention rates. Successfully improving student retention rates ultimately reduces time to get a degree and increases graduation rates. With this, the outcome will be more students graduating that are well-prepared to enter the new economy, and build a more sustained capacity to grow the State's resources.

Financial Aid

The Arizona Financial Aid Trust (AFAT) is used to provide immediate aid to students with verifiable financial needs, assist students who by virtue of special circumstances present a unique need for financial aid, and to create an endowment for future financial aid. A.R.S. § 15-1642 requires the State to provide two dollars for every dollar raised in actual student fees.

The Executive recommendation includes \$6.3 million for the Arizona Financial Aid Trust. Out of this amount, \$2.9 million bring the State funding to the statutory formula by providing a two to one ratio of State funding to student fees. The remaining \$3.4 million are not part of the statutory formula but are recommended to increase the State's support to AFAT.

College of Construction, Arizona State University

The Executive recommends \$1.5 million debt service payments on \$20 million in new 15-year Certificates of Participation (COPs) to support designing and building the Arizona State University (ASU) College of Construction. The recommended funding is the State's share in this project. Other public and private endowment entities will contribute at least another \$20 million to complement this legislative appropriation and establish the new College of Construction. The college will aim at improving the productivity and cost effectiveness of the design and construction industries, and will mitigate the current skilled-labor shortage and enable our local universities to educate and train the future managers of construction.

Research Buildings

Pursuant to Laws 2003, Chapter 267 (HB 2529), the Executive Budget provides funding for the universities for lease-purchase capital financing for research infrastructure projects. The legislation provides continuing year-to-year General Fund appropriations starting in FY 2008 and ending in FY 2031, and allocates funding as follows:

- \$14,472,000 to Arizona State University
- \$14,253,000 to the University of Arizona
- \$5,900,000 to Northern Arizona University

INNOVATION

Science Foundation Arizona (SFA)

The budget includes \$35 million to strengthen Science Foundation Arizona, to enhance Arizona's position in the global economy by investing in science-based research and innovation in areas beneficial to Arizona's long-term competitiveness and quality of life. The funds are to be used to attract world-class researchers to Arizona and support research into new products and technologies that can be commercialized and brought to the market.

This new economy is fueled by innovation, research, advances in science and technology, and skilled creative workers. The SFA is going to be an excellent vehicle within the bio-science roadmap to build and strengthen medical, scientific and engineering research. This will pave the way to increased investment and job creation in the State.

Foreign Direct Investment Program (FDI)

The Executive recommends \$1.2 million to expand Arizona's global efforts and strengthen Foreign Direct Investment. The FDI program will encourage public and private partners to coordinate FDI activities, provide cooperative marketing dollars for new FDI programs, and leverage existing funds. New FDI-focused programs will be launched in Canada, Germany and China to promote business attraction and investment in Arizona, and current FDI programs in Japan, the United Kingdom and Mexico will continue to be enhanced.

Economic Growth Alliance

The Executive recommends \$1.2 million to develop, implement and support global economic development strategies. The recommendation supports statewide, domestic and international efforts to promote the Department of Commerce as a Growth Alliance for private-public partnership in the areas of economic planning, business and community development, and infrastructure finance. The Alliance will consist of diverse economic development expertise with the charge to reach out, align and expand technical and business resources to help communities, investors and entrepreneurs. The Growth Alliance will also serve as a clearinghouse for best practices on a variety of planning topics.

Greater Arizona Development Authority Enhancement

The Budget includes \$5 million in additional capitalization to the Greater Arizona Development Authority (GADA) to address communities' infrastructure needs. The recommended amount will enable local communities and tribal governments to finance public infrastructure projects, accelerate project development, and lower financing costs through the Authority's technical and financial assistance.

CEDC Fund – Funding Shift and Restoration

The recommendation begins the process of restoring Arizona's innovation investment fund by shifting (\$1.3 million) and (7.0 FTE) from the Commerce and Economic Development Commission (CEDC) Fund to the General Fund. The Department is at a competitive disadvantage when recruiting new companies because the Commerce and Economic Development Commission is unable to fulfill its role as the strategic "deal closing" agency. Funding for the CEDC's financial assistance programs is currently derived from two special instant lottery games conducted each fiscal year by the Lottery Commission. Current statutes require that no more than 21.5% of the revenues from those games be transferred to the CEDC Fund. The recommendation will help restore the integrity of the program and strengthen the State's efforts for job creation and business investment.

Tourism Promotion and Economic Development – Office of Tourism

The Executive recommendation supports over \$1.4 million during this biennium budget for marketing and tourism promotion activities. The recommended increase is consistent with the funding level approved by the voters in 2000 under Proposition 302. The increased funding will enable the State to take advantage of the

growing global market and promote Arizona as a domestic and international travel and business destination, and will allow the State to compete for tourism-related economic development expenditures and investments.

FOUNDATION

Innovative Financing - Highway Construction

The Executive recommendation includes \$500 million in bond financing which creates more than \$400 million in net new funds available to accelerate highway construction by expanding bond maturity limit from 20 to 30 years. Increased population growth and geographic dispersion require more strategic expansion of our transportation system capacity and more effective solutions. Acceleration and strategic expansion of our system capacity and other solutions are needed to address our growing mobility needs. Present and future traffic congestion cannot be relieved without significant investment in the transportation infrastructure and ways of managing and maintaining such public assets. Cooperative efforts are needed to ensure that additional financing measures be approved in order to speed up highway construction projects and help address transportation needs in the state.

New School Construction, School Facilities Board

The Executive recommends \$407.7 million for statewide construction of new schools to be financed through a lease-to-own financing mechanism. These monies will be used to build approximately 29 elementary and middle schools the average size of 750 students and 7 high schools the average size of 1,500 students. The lease-to-own mechanism will ensure adequate funding be available to meet construction needs of eligible school districts, provide capital resources for Full-Day Kindergarten, and implement LEED (Leadership in Energy Efficient Design) or other Board approved energy and environmental design standards in new school construction projects.

Water Protection Fund

The Executive recommends \$4 million from the General Fund for the Arizona Water Protection Fund grant program in FY 2008 and FY 2009. Combined with the additional \$1 million from water banking fees, the Water Protection Fund will have at least \$5 million in available revenues in FY 2008. A.R.S. § 45-2112 requires an annual appropriation of up to \$5 million to protect Arizona rivers, streams, and wildlife in riparian habitats. Session law (most recently, Laws 2006, Chapter 349) has suspended this appropriation since FY 2004. The Water Protection Fund grant program is a vital source of funds to public and private local entities to mitigate the effects of severe drought conditions that put river habitats in danger.

Border Security Programs

The State has made a considerable commitment of funds for Border Security. State funding in FY 2007 is roughly \$200 million for such priorities as: Department of Public Safety border-related operations, auto theft enforcement, ports-of-entry enforcement, and incarceration. State agencies are also expanding activities of the Auto Theft and Fraudulent Identification task forces, expanding the use of automated license plate readers, expanding GITEM gang and immigration task force, and modernizing crimes labs. The Executive recommends expanding DPS border security initiatives by about \$5 million and additional funding for inspectors to monitor cross-boundary hazardous waste shipments from Mexico and for the operation of the Hazardous Air Emergency Response. In addition, Arizona's share of FY 2007 federal funding for border security totaled about \$1.3 billion, of which \$600 million was a new increase this year for: additional border patrol agents; additional assistant U.S. Attorneys and immigration judges; National Guard units at the border; border radar and other technology; unmanned aerial vehicles and helicopters; additional Immigration Enforcement detention beds; joint immigration and border control operations among federal, State, local and tribal law enforcement; and additional infrastructure, including border fences, vehicle barriers and infrared cameras.

New Forensic Hospital, Department of Health Services

The current Arizona State Hospital wing, designated as the Forensic Unit, is housed in a 50-year old building that no longer meets the needs or standards for patients and staff in a healthcare facility. Due to the age and condition of the current structure, it is not cost-effective to renovate the building as a forensic unit that would meet security and health standards. The Executive recommends funding for demolition and construction of a new Forensic Unit at ASH to provide functional and secured facility for forensic patients and their health providers. The project is estimated at \$32.2 million.

Capitol Mall Modernization and Renovation, Department of Administration

The Executive recommends \$40 million to begin implementing core components identified in the Capitol Mall Centennial Plan, including the renovation and modernization of the old State health laboratory that is presently not fully utilized. Additionally, funding is recommended to design and develop the core area of the Capitol Mall to align it with Arizona's history and its vision for the future. This initiative reflects efforts from various public and private entities. As envisioned in the Plan, the Capitol Mall will feature a series of sustainable connective infrastructures that make public spaces and services more accessible.

Graduate Medical Education Program

The Executive recommendations include \$3 million increase in state funds matched by \$5.9 million in federal funds to expand the Graduate Medical Education Program, making a total of \$44 million in FY 2008 available to support residency slots in Arizona hospitals.